

REQUEST FOR PERMISSION TO PROCEED WITH 15-DAY NOTICE OF AMENDMENTS TO PROPOSED REGULATION SECTION 19032

The text of the proposed Regulation section 19032, relating to audit procedures, the initial statement of reasons, and the notice of hearing were forwarded to and the notice was published by the Office of Administrative Law on June 14, 2002. The public comment period ended on August 23, 2002. A public hearing was held August 19, 2002. A few oral and written comments were received and staff believes these comments should properly be incorporated into the final adopted regulation.

Staff's responses to the comments and suggested revised language to the proposed Regulation section 19032 have been prepared and are attached to this request. See Exhibit A, a matrix that summarizes the comments and recommendations, and Exhibit B, a more detailed explanation of the comments received and staff's response and recommendation to each of those comments. Staff now requests approval of the revised regulatory language and permission to proceed with a 15-day notice of these changes under the Administrative Procedure Act.

Exhibit B
Synopsis of Comments Received During Regulation 19032 Hearing and Staff
Responses and Recommendations

1. **Comment:** Section 19032(a)(3) should be amended to add something like "if requested by the taxpayer, that the auditor draft the information request and provide it to the taxpayer beforehand before issuing it in a more formal manner." I was involved with an audit in which I asked the auditor to draft the IDR first for review and comment. The auditor refused to do so. When I received the IDR I did not know what the audit issue was and since the taxpayer was in a specialized industry, the information did not exist in the form requested.

Response: The auditor and the taxpayer should work together in a cooperative effort to complete the audit in a timely fashion.

Recommendation: Add the following example to subsection (a)(3): "For example, the auditor and the taxpayer or the taxpayer's representative agree to a procedure in which the auditor would draft an information request, discuss the information request with the taxpayer or the taxpayer's representative, and the auditor could take into account such comments before issuing the formal information request."

2. **Comment:** Suggest adding new section 19032(a)(4)(E) to say something like "inform the taxpayer or the taxpayer's representative whenever the auditor discovers an error which, if corrected, would benefit the taxpayer."

Response: Consistent with the Franchise Tax Board's Mission Statement and Statement of Principles of Tax Administration, it is the policy of the Franchise Tax Board to ascertain overpayments and/or issue refunds where the facts and law support such a conclusion. While staff agrees with the concept, we have concerns as to the suggested language. Staff should make the refund if it is appropriate given the taxpayer's facts and circumstances. Finally, the term "error" assumes a conclusion, i.e., that the taxpayer's filing position was in fact an error.

Recommendation: Staff agrees with the concept and recommends the following language be added to subsection (a)(4)(E): "apply the relevant statutes and regulations in a consistent manner regardless of whether the determination of the correct amount of tax results in a proposed assessment or proposed overpayment."

3. **Comment:** The final statement of reasons should explain or the regulation should be modified to state that it is FTB policy that the demand letter is not issued automatically but instead is subject to the auditor's discretion. The department should state that the demand letter is subject to a reasonableness standard.

Response: Staff agrees that the auditor should use his/her discretion before issuing a demand letter. Revenue & Taxation Code section 19133 authorizes the failure to

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provide information penalty. Section 19133 has a reasonable cause exception to the penalty.

Recommendation: Add the following language to subsection (b)(5)(C)2.: "Before issuing a formal notice and demand to furnish information, the auditor will exercise discretion in a reasonable manner that is appropriate under the relevant circumstances related to that particular audit."

4. **Comment:** The regulation should incorporate FTB's current standard for issuing a demand letter, which is that demand letters are not issued unless there have been two previous failures to respond to requests for information.

Response: Procedures as outlined in audit manuals provide that a formal notice and demand for information will not be issued unless the taxpayer has not been responsive to two prior requests for information.

Recommendation: Modify subsection (b)(5)(C)(3) to add: "A demand letter may be issued upon the taxpayer's failure to respond to an initial request and second request for any item of information."

5. **Comment:** The demand letter should not be issued where the taxpayer explains why it is not cost effective for the taxpayer to respond to a particular request.

Response: The role of the auditor is to develop and document the facts and apply and administer the law in a reasonable, practical manner consistent with applicable federal and California law and the Statement of Principles of Tax Administration. The auditor will use discretion and take into account the taxpayer's facts and circumstances in evaluating the need to issue a demand letter. Audit intrusiveness may be minimized if an agreement is reached on an issue assuming there is some level of factual development to support the proper tax treatment of an item. The taxpayer and auditor could then agree with the proper treatment of an item without additional factual development. The agreement must be in writing to insure that the taxpayer, auditor and future users of the audit file understand what was agreed to. Absence such an agreement, the demand letter and/or subpoena is needed to ensure that uncooperative taxpayers provide requested information to factually develop contested issues.

Recommendation: Add the following to subsection (b)(5)(C)(4): "A demand letter shall not be issued where the taxpayer provides a written statement that satisfies each of the following conditions:

- a. Taxpayer's agreement as to the known facts regarding an issue,
- b. Taxpayer's statement that information requested to develop the audit issue further will not be provided, and

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c. Taxpayer's agreement with the audit adjustment."

- 6. Comment:** Section 19032(b)(5)(I) should be clarified as to when the taxpayer may request a copy of the audit file and to whom such a request should be directed. The current version implies that the taxpayer could ask the auditor for a copy of the audit file.

Response: The required procedures to be followed for obtaining copies of audit workpapers is beyond the scope of this regulation, in part because some items, such as address or contact information, may change over time.

Recommendation: Issue a FTB Notice explaining the procedures to be followed for obtaining a copy of a taxpayer's audit file.

- 7. Comment:** Regulation section 19032(b)(5)(I) currently states that if requested, a copy of the audit file will be provided to the taxpayer to the extent not prohibited by law or protected by privilege. The final statement of reasons should explain what law prohibits disclosure such as the Taxpayer's Bill of Rights. It was suggested that the department delete the words "or protected by privilege" as in his opinion the audit file is not protected by privilege under the law and as a matter of policy the complete file should be provided to the taxpayer.

Response: The department is "prohibited by law" (Rev. & Tax. Code sections 19542 et seq.) from releasing third party taxpayer information unless the Revenue and Taxation Code authorizes the disclosure. "Information exempt by law" from production is a more accurate description of what the department may withhold from release. The Public Records Act (Govt. Code sections 6250 et seq.) includes numerous categories of information which public agencies either are not required to release or are prohibited from releasing. For example, Government Code section 6254(k) covers "[r]ecords the disclosure of which is exempted or prohibited pursuant to federal or state law, including, but not limited to, provisions of the Evidence Code relating to privilege" which incorporates by reference, for example, the attorney/client privilege of Evidence Code section 954. This privilege allows the client, here the department, to refuse to disclose confidential attorney/client communications which appear in audit files. Also incorporated by reference would be Revenue and Taxation Code section 19544, which allows the department to refuse to disclose audit selection standards upon a determination that disclosure will "seriously impair assessment, collection, or enforcement" of the income tax laws. The Information Practices Act (Civ. Code sections 1798 et seq.) governs agencies' collection, maintenance, and dissemination of "personal information" (as defined), and specifies both the circumstances under which this information may be disclosed and the circumstances under which the information need not be disclosed. For example, information compiled for the purpose of a criminal investigation need not be disclosed under Civil Code section 1798.40(b).

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Recommendation: Revise subsection (b)(5)(I) to delete "or protected by privilege" and replace it with "or exempted by law from production."

Exhibit A
Proposed Regulation 19032
Staff Responses and Recommendations to Comments Received During Regulation Hearing
Held on August 19, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<i>Revisions to Initial Text</i>
<i>Initial Text Suggested for Deletion</i>

	Public Comment	Staff Response	Staff Recommendation	Subdivision	Changes to Initial Proposed Regulation
1.	In regards to (a)(3), suggest adding language to the effect that "if requested by the taxpayer, that the auditor draft the information request and provide it to the taxpayer beforehand, before having issued it in a more formal manner." The current language in the regulation needs to be stronger to illustrate the benefits of the working relationship in reducing confusion and duplicative effort.	Agree.	Adopt public's suggestion and incorporate into regulation.	(a)(3)	The auditor and the taxpayer or the taxpayer's representative should work together to make information requests relevant and reasonable including the use of alternative sources of information in order to substantiate the facts and circumstances of the issue under audit. <i>For example, the auditor and the taxpayer or the taxpayer's representative may agree to a procedure in which the auditor would draft an information request, discuss the information request with the taxpayer or the taxpayer's representative and the auditor would take into account such comments before issuing the formal information request.</i>
2.	Recommend adding paragraph (E) to subsection (a)(4) that FTB staff has a duty of informing taxpayers whenever the auditor discovers an error in favor of the taxpayer. (E) <i>inform the taxpayer or the taxpayer's representative whenever the auditor discovers a possible error which, if corrected, would or might benefit the taxpayer.</i>	Agree. Staff agrees with the purpose for the comment, but changed the wording to reflect similar language within (a)(4).	Adopt public's suggestion and incorporate into regulation.	(a)(4)(E)	<i>apply the relevant statutes and regulations in a consistent manner regardless of whether the determination of the correct amount of tax results in a proposed assessment or proposed overpayment.</i>
3.	Penalties should not be <i>automatically</i> imposed for failure to provide information (even after two requests) and such penalties should only be imposed where the imposition is reasonable under all the relevant circumstances. To the extent the audit staff has discretion the discretion should be exercised in a reasonable manner that is appropriate under all the relevant circumstances related to that particular audit.	Agree. Staff agrees with adding language to clarify reasonableness when determining whether to issue a demand letter.	Adopt public's suggestion and incorporate into regulation under the discussion of Information Document Requests.	(b)(5)(C)(2)	Failure to provide a timely and complete response to a request from the Franchise Tax Board for additional information might result in the audit being determined by resolving questions of fact to which the requests relate against the taxpayer in addition to assessment of penalties as provided by Revenue and Taxation Code section 19133 for failure to furnish information upon demand. <i>Before issuing a formal notice and demand to furnish information, the auditor will exercise discretion in a reasonable manner that is appropriate under the relevant circumstances related to that particular audit.</i>
4.	To address public concern over the use of the demand letter, the regulation should provide a	Agree.	Adopt public's suggestion and incorporate into regulation.	(b)(5)(C)(3)	<i>A demand letter may be issued upon the taxpayer's failure to respond to an initial request and second request for any item of</i>

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	Public Comment	Staff Response	Staff Recommendation	Subdivision	Changes to Initial Proposed Regulation
	reference point for taxpayers that a demand letter will not be issued prior to a taxpayer's failure to provide information after two requests for said information.				<u>information.</u>
5.	The demand letter should not be issued where the taxpayer explains why it's not cost effective for the taxpayer to respond to a particular request.	Staff agrees that discretion should be used when issuing a demand letter. Audit intrusiveness may be minimized if agreement is reached on an issue, even if full factual development has not been completed. A written agreement clarifies the understanding for all future users of the audit file. However, the demand letter is still needed to ensure uncooperative taxpayers provide requested information to factually develop contested issues during the audit process.	Adopt public's suggestion and incorporate into regulation.	(b)(5)(C)(4)	<u>A demand letter shall not be issued where the taxpayer provides a written statement that satisfies each of the following conditions:</u> a. <u>Taxpayer's agreement as to the known facts regarding an issue.</u> b. <u>Taxpayer's statement that information requested to develop the audit issue further will not be provided, and</u> c. <u>Taxpayer's agreement with the audit adjustment.</u>
6.	The regulations should clarify how taxpayers request copies of their audit files so there are no misunderstandings.	Agree. Staff agrees with providing clearer guidance on how to request a copy of an audit file	Issue an FTB Notice explaining the procedures for obtaining copies of audit files. A specific procedure for requesting information is more appropriate outside of this regulation.		No change necessary.
7.	In regards to providing a copy of the audit file, the following phrase is unclear, "a copy of the audit file will be provided to the extent not prohibited by law or protected by privilege." Recommend deleting "or protected by privilege". Request FTB staff explain what "prohibited by law" means. Alternatively, suggest that the language "to the extent not prohibited by law" be changed to: <u>"to the extent not prohibited by those statutory prohibitions intended to protect taxpayers' rights of confidentiality".</u>	Staff agrees that language should be clarified. The various laws dealing with disclosure are beyond the scope of this regulation, which is limited by the Initial Statement of Reasons to the audit process. The purpose of this provision is to advise taxpayers that they may request a copy of the audit file, and that the copy will be provided, subject to any applicable disclosure limitations.	Adopt public's suggestion of deleting "privilege" language and add "or exempted by law from production" to clarify that FTB will provide a copy of the audit file consistent with applicable disclosure laws that are not the subject of this regulation.	(b)(5)(I)	Copy of Audit File. If requested by the taxpayer or the taxpayer's representative, a copy of the audit file will be provided to the extent not prohibited by law <u>or exempted by law from production.</u> or protected by privilege.

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Proposed Regulation

Section 19032

November 26, 2002

§ 19032. Audit Procedures.

(a) General.

(1) The purpose of the audit is to efficiently determine the correct amount of tax based on an analysis of relevant tax statutes and regulations and case law as applied to the facts of the audit.

(2) In general, the audit of a tax return must be completed in sufficient time to permit the issuance of a notice of proposed deficiency assessment or proposed overpayment within the applicable statute of limitations. Consequently, audits must be completed within four years after the date the original tax return was filed unless a longer period for issuance of a notice of proposed assessment is provided for under the Revenue and Taxation Code, or the taxpayer consents to extend the period of assessment under Revenue and Taxation Code sections 19065, 19067, or 19308. To facilitate the timely and efficient completion of an audit within the above-referenced statutory timeframes, the taxpayer should have the expectation that the audit of the tax return would be conducted in a manner so that resolution of the audit will be achieved within a two-year period commencing with the date of “initial audit contact” as subsequently defined. This two-year guideline will not apply in the following circumstances:

(A) False or fraudulent tax returns. False or fraudulent tax returns are those filed where an activity or conduct as described under Revenue and Taxation Code section 19701 or 19705 has occurred.

(B) Audits that are delayed as a result of the taxpayer’s bankruptcy proceedings.

(C) Audits in which a demand for information letter citing the failure to furnish information penalty, Revenue and Taxation Code section 19133 has been sent to the taxpayer or the taxpayer’s representative.

(D) Audits involving proceedings concerning the enforcement or validity of a subpoena or subpoena duces tecum.

(E) There is a request for consideration of Revenue and Taxation Code section 25137 petition, but only in relation to the effect of the petition request. The issuance of notices may be delayed pending the outcome of the petition request.

(3) Taxpayer's Duty to Respond. A taxpayer, or the taxpayer's representative has the duty to make a timely response to requests for information or documents by the Franchise Tax Board that are relevant and reasonable or provide an explanation as to why additional time is necessary to respond or state why the request is not relevant or reasonable.

The auditor and the taxpayer or the taxpayer's representative should work together to make information requests relevant and reasonable including the use of alternative sources of information in order to substantiate the facts and circumstances of the issue under audit. ***For example, the auditor and the taxpayer or the taxpayer's representative may agree to a procedure in which the auditor would draft an information request, discuss the information request with the taxpayer or the taxpayer's representative, and the auditor would take into account such comments before issuing the formal information request.***

(4) Duty of Franchise Tax Board Staff. Franchise Tax Board staff has the duty to:

(A) apply and administer the law in a reasonable, practical manner consistent with applicable federal and California law and the Statement of Principles of Tax Administration,

(B) take into account the materiality of an issue being audited as defined in subsection (a)(7) of this regulation,

(C) make relevant and reasonable information requests for the issues under examination as provided for in Revenue and Taxation Code section 19504:

1. The auditor shall explain the relevance or reasonableness of the request when asked to do so,
2. Requests for information are relevant if the requested information is germane to or applicable to the audit issue, and
3. The auditor and the taxpayer or the taxpayer's representative should work together to make information requests relevant and reasonable including the use of alternative sources of information in order to substantiate the facts and circumstances of the issue under audit.

(D) timely analyze information received or responses submitted and to request additional relevant information or inform the taxpayer of the potential audit determination.

(E) apply the relevant statutes and regulations in a consistent manner regardless of whether the determination of the correct amount of tax results in a proposed assessment or proposed overpayment.

(5) Duty to Maintain Records. Generally, it is the taxpayer who will be in possession or control of the necessary information, documents, books and records and who will have the knowledge regarding the circumstances of the relevant activities such that a determination of the correct tax can be made. The inability, or failure, of a taxpayer to supply requested relevant information in support of the tax return as filed may result in a Notice of Proposed Assessment being issued. A taxpayer has a duty to maintain relevant records and documents pursuant to normal accounting or regulatory rules and the rules set forth in the Revenue and Taxation Code or the Internal Revenue Code as applicable for California purposes. The Franchise Tax Board recognizes that taxpayers are sometimes not able to respond to each and every request for data. The auditor should work with the taxpayer to resolve difficult information requests or any other problems in generating information document request responses.

(6) Application of Time Limits. The guidelines of this regulation are intended to provide for an orderly process that leads to a quick conclusion to the audit and are not to be used to foreclose or limit a taxpayer's right to provide information in support of the tax return as filed or amended.

(A) The Franchise Tax Board recognizes that some Information Document Requests, Audit Issue Presentation Sheets or Position Letters can be responded to in less than 30 days while other responses will require time in excess of 30 days. (See subsection (b)(5) of this regulation for definitions of referenced documents.) The auditor has discretion to take into account the taxpayer's facts and circumstances in establishing the original response time or to allow extensions of time to respond.

(B) The auditor shall take into account responses to Information Document Requests and Audit Issue Presentation Sheets received after the established date for a response, provided the audit of the taxable year has not been closed.

(C) The guidelines identified in this regulation do not supersede or have any bearing on the statute of limitations for issuing deficiencies or refunds as provided by the Revenue & Taxation Code. Failure to adhere to the guidelines of the regulation will have no effect on the validity of a notice of proposed assessment, offset, notice of proposed overpayment, or no change letter issued within the applicable statute of limitations period, or on any rights of the taxpayer.

(7) Materiality. Audit issues are based on the materiality of the potential adjustment and balanced with the statutory requirement to determine the correct amount of tax. If potential for an audit adjustment is likely, the issue should be pursued if the materiality of the potential adjustment warrants the audit resources necessary to audit the issue. Auditors will use judgment as to what constitutes materiality for purposes of this subsection as materiality is a facts and circumstances test. The auditor will discuss materiality at any time during the audit if so requested.

(8) This regulation shall be applicable for initial audit contacts made on or after the effective date of this regulation within the meaning of Government Code Section 11343.4.

(b) Audits.

(1) Type of Audit. The Franchise Tax Board staff will determine if the audit will be a field audit or a desk audit based on the complexity of the tax return and which type of audit will be more conducive to effective and efficient tax administration. The taxpayer may offer input on the determination of the type of audit for the Franchise Tax Board staff to consider.

(2) Field Audits.

(A) Definition of Field Audit. A “field audit” is an audit that takes place at the taxpayer’s residence, place of business or some other location that is not an office of the Franchise Tax Board. For field audits, “initial audit contact” as used in subsection (a)(2) of this regulation is defined as the date of the first meeting between the taxpayer and/or the taxpayer’s representative and a member of the Franchise Tax Board audit staff. Generally, the Franchise Tax Board staff should first contact the taxpayer within two years of the date on which the tax return is filed.

(B) Location of Field Audit. A field audit will generally take place at the location where the taxpayer’s original books, records, and source documents pertinent to the audit are maintained. In the case of a sole proprietorship or business entity, this will usually be the taxpayer’s principal place of business. Field audits can be moved to a Franchise Tax Board office, or the taxpayer’s representative’s office, if the taxpayer (or the taxpayer’s representative) does not have the appropriate work area available or the taxpayer or the taxpayer’s representative does not have time available for the audit to be conducted at their location, or as circumstances of the taxpayer warrant.

(C) Site Visitations. Regardless of where the audit takes place, the Franchise Tax Board staff may visit the taxpayer’s place of business or residence to establish facts that can only be established by direct visit, such as inventory or asset verification. The Franchise Tax Board staff generally will visit for these purposes on a normal workday of the Franchise Tax Board during the Franchise Tax Board’s normal duty hours.

(D) Requests by Taxpayers to Change Place of Audit. The Franchise Tax Board staff will consider, on a case-by-case basis, written requests by taxpayers or their representatives to change the place that the Franchise Tax Board has set for an audit. Reasonable requests to move an audit to another of the taxpayer’s offices or to the taxpayer’s representative’s office will be

granted unless doing so would impose an unreasonable burden to the Franchise Tax Board staff or significantly interrupt the audit schedule.

If the taxpayer requests that the audit be conducted at a Franchise Tax Board office, or the taxpayer's-representative's office, it is the taxpayer's responsibility to deliver all books and records necessary for the audit.

(3) Definition of Desk Audit. A "desk audit" is an audit conducted primarily through mailed correspondence. For desk audits, "initial audit contact" as used in subsection (a)(2) of this regulation is defined as the date of the first letter to the taxpayer regarding the audit. Generally, the Franchise Tax Board staff should first contact the taxpayer within two years of the date on which the tax return is filed.

(4) Time of the Audit. It is reasonable for the Franchise Tax Board to schedule the day or days of the audit during a normally scheduled workday or workdays of the Franchise Tax Board, during the Franchise Tax Board's normal business hours. It is reasonable for the Franchise Tax Board to schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of particular taxpayers or their representatives. However, the Franchise Tax Board will work with taxpayers or their representatives to try to minimize any adverse effects in scheduling the date and time of the audit.

(5) The following audit procedures may be used either in field or desk audits depending on the nature of the audit.

(A) Opening Conferences. Items to be discussed during the opening conference include, but are not limited to, estimated timeframes to complete the audit, the scheduling of future audit appointments, discussion of the scope of the audit, the taxpayer's record retention policy, status of federal audits, amended returns, any corrections to information reported on the return that the taxpayer has identified and wants the auditor to take into account, information document requests, and photocopying.

At the opening conference, or via mail if no opening conference is held, the auditor shall provide a written document stating the name and phone number of the audit supervisor and manager, and any designated issue specialists assigned to the audit.

(B) Audit Plan. A written audit plan may be drafted as appropriate, or if requested by the taxpayer, documenting key dates related to conducting the examination, identifying key points of the examination, or identifying other items discussed during the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative. The audit plan is considered a guideline for conducting the examination and can be amended throughout the audit process as circumstances warrant.

(C) Information Document Request (IDR). The Franchise Tax Board may provide a taxpayer an Information Document Request (IDR) requesting single or multiple documents. As a general rule, response times shall be determined on an IDR by IDR basis with a maximum response time of 30 days from the date the IDR was hand delivered to the taxpayer, or the taxpayer's representative by the auditor or the date mailed by the auditor or as otherwise provided for in subsection (a)(6)(A) of this regulation.

1. As a general rule, where a reply by the auditor is appropriate or the auditor needs additional information, the auditor will notify the taxpayer or the taxpayer's representative within 30 days of the auditor's receiving the response to the IDR. Notification is achieved by issuance of additional IDRs, an Audit Issue Presentation Sheet or Position Letter, or by a response indicating additional time is necessary to respond and providing a date for future contact.

2. Failure to provide a timely and complete response to a request from the Franchise Tax Board for additional information might result in the audit being determined by resolving questions of fact to which the requests relate against the taxpayer in addition to assessment of penalties as provided by Revenue and Taxation Code section 19133 for failure to furnish information upon demand. ***Before issuing a formal notice and demand to furnish information, the auditor will exercise discretion in a reasonable manner that is appropriate under the relevant circumstances related to that particular audit.*** In addition, subpoenas may be issued as authorized by Revenue and Taxation Code section 19504 to obtain relevant information.

3. ***A formal notice and demand to furnish information may be issued upon the taxpayer's failure to comply to an initial request and second request for any item of information.***

4. ***A formal notice and demand to furnish information shall not be issued where the taxpayer provides a written statement that satisfies each of the following conditions:***

- a. ***Taxpayer's agreement as to the known facts regarding an issue.***
- b. ***Taxpayer's statement that information requested to develop the issue further will not be provided, and***
- c. ***Taxpayer's agreement with the audit adjustment.***

(D) Photocopying. The Franchise Tax Board has the authority pursuant to the provisions of Revenue and Taxation Code section 19504, to require either the submission of relevant photocopied documents, or that relevant information be made available for photocopying, scanning or other electronic

reproduction at a specified time and place for the purposes of administering and verifying compliance with the tax laws. Photocopying is a benefit to both the Franchise Tax Board and the taxpayer as the photocopy provides objective evidence supporting a tax position and allows for expediting the audit.

(E) Audit Conference. Conferences should be held throughout the audit to review the status of IDRs or to discuss proposed adjustments and to ensure that the audit is on track to finish within the estimated completion time discussed during the opening conference.

(F) Audit Issue Presentation Sheet (AIPS). An Audit Issue Presentation Sheet (AIPS) may be used during the course of the audit as soon as the issue is completed to inform the taxpayer of proposed audit adjustments. If an AIPS is not provided, the taxpayer or the taxpayer's representative may request one. AIPS provide the facts, law, analysis and the auditor's tentative conclusion concerning a specific issue. The taxpayer will be asked to provide a response confirming or denying the correctness of the factual description of the issue and will be provided an opportunity to provide additional facts and documents or other authority to rebut the auditor's conclusion within a period not to exceed 30 days from the date the AIPS was hand delivered to the taxpayer, or the taxpayer's representative by the auditor or the date mailed by the auditor or as otherwise provided for in subsection (a)(6)(A) of this regulation.

(G) Closing Conference. Items discussed during the closing conference will generally include an explanation of the audit adjustments, the audit schedules, the review process and protest rights.

(H) Position Letter. At the close of an audit, the auditor may provide, or the taxpayer or the taxpayer's representative may request a position letter. The position letter will explain the facts relied on, relevant law, analysis and conclusions on all audit adjusted issues, or may refer to previous AIPS.

1. Audit schedules, if applicable will be provided with the position letter.
2. The taxpayer or the taxpayer's representative will be provided an opportunity to respond to the position letter within a period not to exceed 30 days from the date the closing letter was hand delivered to the taxpayer, or the taxpayer's representative by the auditor or the date mailed by the auditor or as otherwise provided for in subsection (a)(6)(A) of this regulation.
3. If the taxpayer or the taxpayer's representative responds to the closing letter with additional facts or authorities for the auditor to

consider, the auditor will issue a revised closing letter to take into account the additional facts or authorities.

(I) Copy of Audit File. If requested by the taxpayer or the taxpayer's representative, a copy of the audit file will be provided to the extent not prohibited by law *or exempted by law from production*.

(c) The audit results may also be subject to additional review by Franchise Tax Board staff to ensure that the audit recommendations are consistent with Franchise Tax Board policies, practices, and procedures. Adjustments to the audit recommendation made by review staff will be communicated to the taxpayer or the taxpayer's representative by the auditor or reviewer. Franchise Tax Board staff will complete its review and notices will be issued within 90 days after the close of the audit.

(d) "Automated Audits" generally involve a routine application of well established law or address discrepancies in income or deductions as identified through matching state tax return information to federal tax return information and other income or expense information returns, including, but not limited to, wage payments shown on Form W-2, or interest payments shown on Form 1099. Automated audits may include a request for additional information from the taxpayer, such as a completed head of household audit letter, or may be completed without any additional information being requested from the taxpayer. In these cases, taxpayers will receive a Notice of Proposed Assessment proposing to assess additional tax and explaining the reasons for the proposed assessment. Usually, these audits are not assigned to a specific auditor, but may be assigned to other technical staff members.

(e) Amended returns received after commencement of an audit. If one or more amended returns are filed after an audit of the original tax return has commenced, the audit of the amended return is distinct from the audit of the original tax return for purposes of the guidelines provided for in subsection (a)(2) of this regulation. The Franchise Tax Board will use the information developed during the audit of the original return to the extent possible to avoid duplicating prior audit activity.

(f) Federal Audit Adjustments.

(1) The California Revenue and Taxation Code and Internal Revenue Code contain reciprocal provisions permitting an exchange of information. Under these provisions, the Franchise Tax Board may receive a copy of a final federal determination from the Internal Revenue Service. If notification of the final federal determination is received during the audit of the original tax return, adjustments proposed as a result of the federal audit may be incorporated into an ongoing audit. If the audit of the original tax return has been completed, separate notices will be issued reflecting the federal adjustments.

(2) The guidelines described in subsection (a)(2) of this regulation do not supersede or have any bearing on the statute of limitations as provided by the

Revenue and Taxation Code to issue assessments or refunds based on final federal determination.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 19032, Revenue and Taxation Code.